

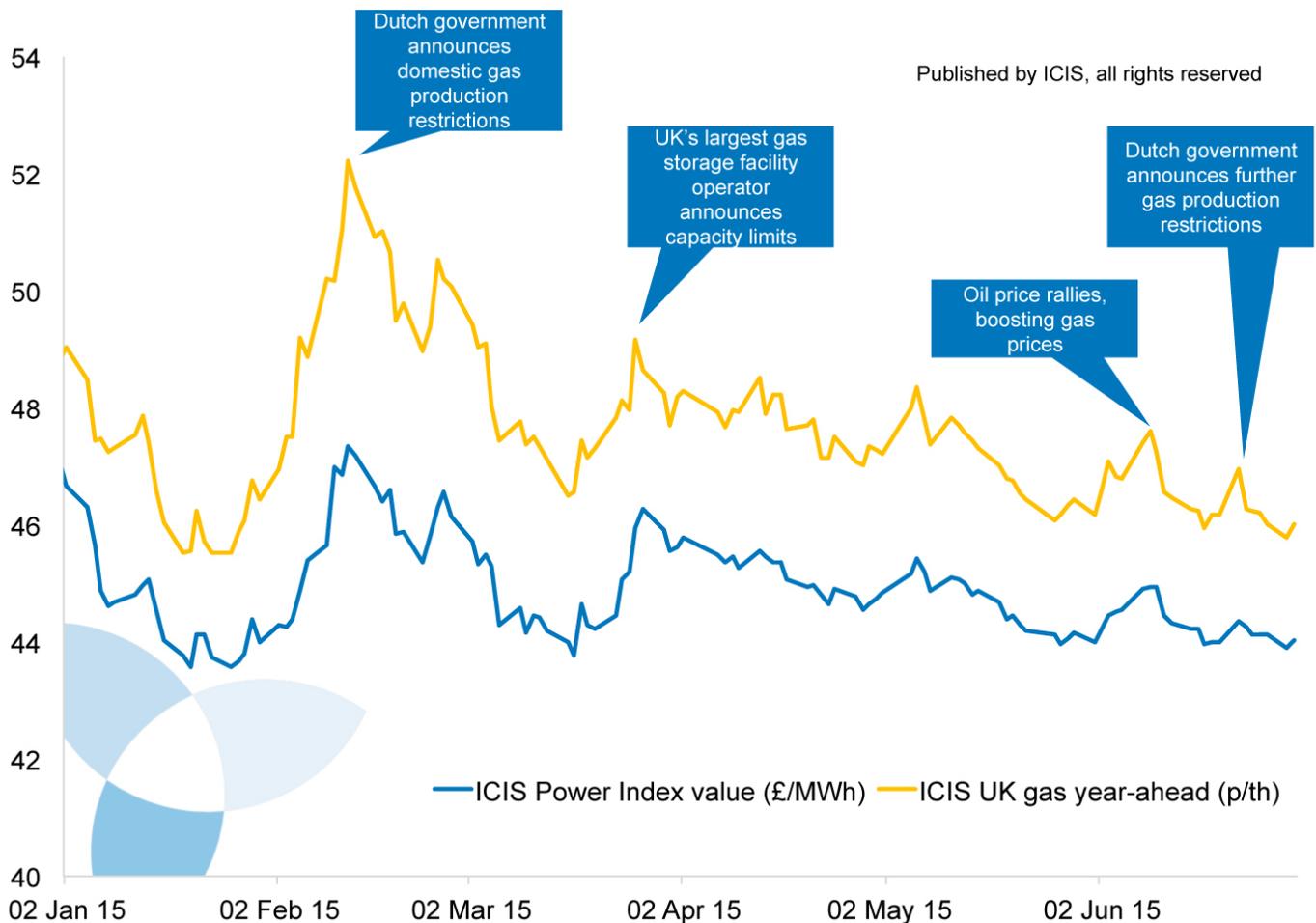


Highlights

- Wholesale UK gas and electricity market prices are at their lowest quarterly average in five years, according to the ICIS Power Index and the ICIS price for gas to be delivered over the next year. Prices have been influenced by the fall in the oil market, alongside more gas supply and renewable power capacity.
- UK energy prices have also been pushed down by concerns over Greece exiting the euro. As the value of the euro has fallen relative to sterling, UK gas has become more expensive for European buyers, and is therefore less in

demand. As UK gas prices have fallen, UK power prices have also been affected.

- Gas imports from LNG have fallen in Q2, but weak demand from higher priced markets in Asia, combined with more LNG supply, leaves the UK well positioned to attract more LNG cargoes over the rest of the year.
- It is uncertain whether prices will continue to fall during Q3, with the UK holding less gas in storage than last year, and European markets potentially needing more gas from the UK, with less Dutch gas production and Ukraine likely to purchase more gas.



Source: ICIS Power Index (www.icis.com)



Price moves

UK gas and electricity prices hit five-year lows during Q2 2015, with the ICIS Power Index averaging £44.72/MWh (per megawatt hour), and the price of gas to be delivered over the next calendar year averaging 47.1 pence per therm (p/th).

The gas price for Q2 was down 2% from the Q1 average. The power equivalent fell less from the previous record low in Q1, nudging down by 0.8%. This indicates that power market participants are more reluctant to sell, given the tight supply margins for flexible generation this winter. Day-on-day changes were also less pronounced for power than gas.

Underlying price trends

Gas and electricity prices continued to decline steadily over Q2.

The price of gas delivered for the upcoming winter reached 47.4p/th during Q2 on 17 June 2015 – the lowest that gas for this winter 2015/16 has ever closed, and the lowest that any winter gas has been priced in five years.

This has also affected electricity prices, as gas remains the most significant influence as a fuel for generation.

Macroeconomic factors

Another key difference in prices this year is the devaluation of oil-indexed gas contracts, where gas is sold on the basis of the Brent crude oil price over the previous six to nine months.

Q2 was the first quarter to include the full impact of the lower oil price, as the oil price decline gathered pace from July last year. Brent crude oil prices were more expensive than Q1, rising above \$60/bbl at the start of Q2, but show little sign of regaining previous highs of more than \$100/bbl in 2014.

As a result, gas sold under contract is increasingly cheap, and the lower cost of this gas supply to the European markets has helped to bring gas prices down further.

Currency also affects UK gas prices, as European participants buy gas in euros. Sterling gained against the euro during Q2 overall, making UK gas less attractive to European buyers and therefore keeping UK gas prices lower. Sterling was cheapest against the euro two days before the general election, but has since strengthened.

LNG supply steady

Liquefied natural gas (LNG) cargoes continue to come to the UK, and this source of supply is one of the factors that has helped to bring gas and electricity prices down.

However, volumes imported into the UK have steadied in recent months. From a sharp year on year increase in Q1, UK LNG volumes in Q2 have fallen by 14%, particularly in June.

ICIS estimates that 2.3m tonnes have been imported to the UK during Q2, in 16 cargoes.

Long-term, the UK remains an attractive market for any LNG not already contracted elsewhere under a long-term agreement, partly because of the size of its traded market – enough volume changes hands on the UK gas market that an extra LNG cargo is not likely to distort the local market price, and there is enough buying interest that sellers can be reasonably sure of finding a counterpart quickly.

However, in Q2, Mexico, Egypt and Argentina have all started to buy LNG from the open market, absorbing some of the cargoes that might have come to the UK.

Potential upside

However, at the end of Q2, market participants consider that the decline in gas prices may have slowed if not stopped, with traders reluctant to value gas any lower.



The key risk factors continue to be low levels of gas in storage, which could affect winter supply, and also the falling production from the Groningen gas field in the Netherlands.

The tensions between Russia and Ukraine also remain unresolved, with the Ukrainian state company Naftogaz indicating that it will no longer purchase Russian gas from 1 July. Halting this source of imports will increase Ukraine's reliance on other sources, including European gas markets, which could increase UK gas prices as a result.

Low storage

British gas storage stocks reached 13% on 8 May, but have since climbed to 37% at the end of Q2.

However, British stocks are 43 percentage points lower than they were at this time the previous year.

Traditionally, most gas is injected during the summer months, as traders can buy gas more cheaply when demand is low, and store it to sell during the winter, when demand is higher.

At the end of Q2, there was little economic incentive for participants to buy gas to store, as prices for winter delivery were not valued high enough above summer prices to make the cost of storage worthwhile.

Many traders are expecting cheaper oil-indexed gas in Q3 2015 to fill storage sites in continental Europe, leaving more domestically produced gas for injections into British sites. The UK has strong interconnection with continental Europe and its gas storage facilities, so participants are not as concerned about potential supply shortages as they have been previously.

There is also less gas storage available at the Rough facility, which stores gas in a depleted oil field and accounts for 80% of the UK's gas storage availability. Facility operator Centrica is expecting to make an announcement in September.

Dutch gas supply shortages

The Netherlands will reduce production from the Groningen gas field by more than expected, the government announced at the end of June.

The Dutch government capped 2015 production at a maximum of 30 billion cubic metres (bcm) at the end of June, down 24% from the previous 39.4bcm cap announced in December. While gas from the Groningen field itself is used for domestic Dutch demand and not exported to the UK, the shortage of the so-called 'low-calorific' gas means that other 'high-calorific' gas usually exported to Britain via the BBL pipeline is now being kept in the Netherlands.

The Netherlands has become a net importer for the first half of 2015, and the reduction means that not only will the Netherlands' exports to the UK fall, but the country is expected to import more gas to meet domestic demand, which could boost UK gas prices as supply diverts to meet demand elsewhere.

Power trends

Power price movements were more subdued than the equivalent movements on the gas side, but the influence continues.

Solar uncertainty

Uncertainties in power market pricing remain. Solar capacity is expected to have a greater influence this year than last, with National Grid estimating as much as 100MW of new solar capacity connecting to the grid each month. Today the total stands at 7.4GW according to National Grid, equivalent to around three-quarters of the UK's nuclear power capacity.

The coalition government's plans to close the previous renewable generation subsidy scheme, the Renewable Obligation, were announced early last year, and this has caused a surge in solar installations as developers raced to meet the deadline. In addition, the amount of small-



scale solar capacity, installed by households and businesses, is also growing. Solar supply is not directly connected to the transmission grid, and production is therefore harder to monitor.

This new supply will pressure power prices further. The government also announced long-term plans to cut support for onshore wind from 2016 onwards, but 5GW of projects are already expected, so there is likely to be little additional impact on prices.

Reserve generation

Traders remain focused on potential generation shortages for this winter.

But while concerns remain, National Grid tendered for more reserve capacity with results announced at the end of June. The grid operator secured another 1.8GW of power generation to be available to meet peaks in demand from 06:00 -20:00 from November to February.

The total supplemental balancing reserve (SBR) is now 2.6GW, none of which will be able to operate in the wholesale market.

The results have led to some less profitable plants leaving the market. However, while some plants are choosing to leave the market, these were typically generating low volumes if any, after a mild winter caused demand to fall.

Traded volumes

The more stable picture for pricing has impacted the amount of traded volume.

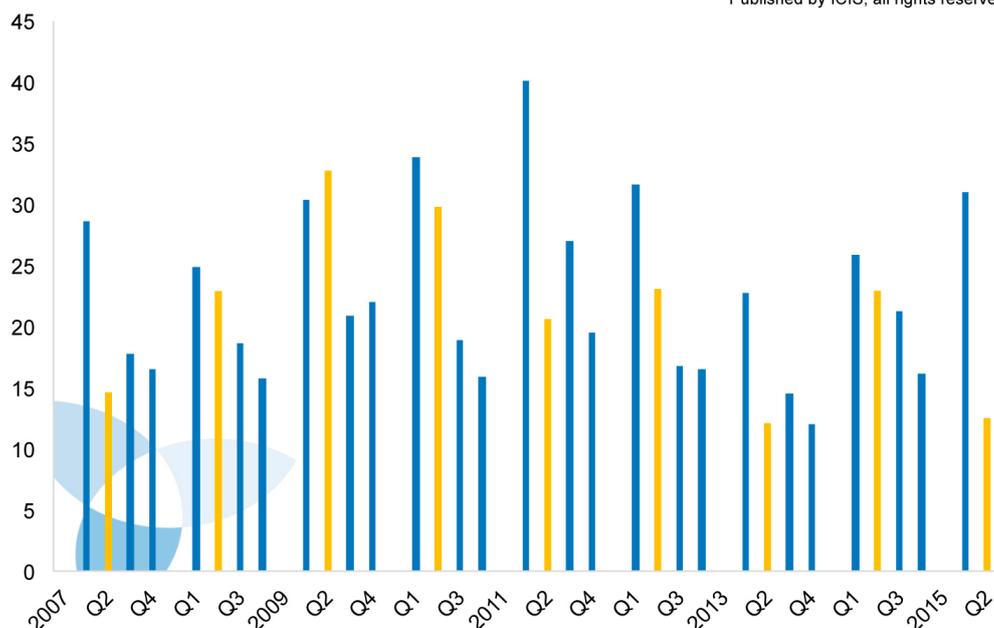
At 12.5GW, Q2 2015 volumes for the IPI were the lowest volumes for Q2 since 2013, which was the lowest Q2 volumes ever seen for the ICIS Power Index, calculated back to 2007.

This is a sharp contrast to volumes during Q1, which were the highest in three years.

There has been longstanding concern about falling UK power market liquidity, and the British regulator Ofgem introduced a mandatory market-making obligation on the largest market participants last year. The move has concentrated trading into two hour-long windows during the trading day, which has improved liquidity for those periods, but some participants suggest the intervention may have lessened trading activity outside those times.

Traded volumes in GW

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Source: ICIS Power Index (www.icis.com)



Outlook for Q3

At the end of Q2, many market participants expected gas and electricity prices for long-term delivery to stabilise at low levels.

- The low crude oil price is expected to become more obvious from July, with more gas supply from long-term contracts indexed to oil. These contracts typically have a six-to-nine month time lag which means crude's decline in late 2014 will become more obvious. Oil-indexed gas contracts to the UK have been phased out, but they are an important feature in mainland Europe, which typically purchases UK gas for delivery through the Interconnector pipe to Belgium during summer months.
- However, traders are wary of gas prices falling too far, with the risk of low UK storage levels ahead of the winter, and less Dutch gas production than expected. European stocks are available to the UK via pipeline capacity, and the Rough gas storage facility is expected to return to service in September, but this is still unconfirmed.
- Uncertainty over Greece remaining in the euro is likely to continue to affect the UK gas price, as European gas buyers adjust to their buying power in sterling.
- LNG volumes are expected to continue to come to the UK, with a surge in new global LNG production, principally from Australia and the United States. Over 40 million tonnes of additional capacity will come to market in the next year, providing planned projects start up on time, a 17% increase on last year's global LNG production. This is expected to bring cargoes with flexibility over delivery back to Europe from Asia.
- Additional renewable capacity could undermine long-term electricity prices further, as market participants track how prices for short-term delivery respond to extra generation.



About the IPI

About ICIS The ICIS Power Index (IPI) gives homes and businesses an insight into price trends on the UK wholesale electricity market.

Robust energy markets are vital to the UK economy, and the IPI makes electricity price trends and activity more visible and accessible to household consumers and commercial buyers, as well as media and policy-makers.

The IPI is published daily by ICIS, an independent authority on UK electricity market pricing, and is available at:

www.icis.com/energy/electricity/icis-power-index/

ICIS is an independent price reporting agency focusing on global energy, petrochemical and fertilizer markets, and we have covered the complex UK electricity market for nearly two decades. Every day, we assess electricity contracts for more than 40 different delivery periods in the UK market alone. The analysis and data that we produce is widely used as a reference price in energy contracts.

It is our aim to give companies in global commodities markets a competitive advantage by delivering trusted pricing data, high-value news, analysis and independent consulting, enabling our customers to make better-informed trading and planning decisions. With a global staff of more than 800, ICIS has employees based in Houston, Washington, New York, London, Montpellier, Dusseldorf, Karlsruhe, Milan, Mumbai, Singapore, Guangzhou, Beijing, Shanghai, Yantai, Tokyo and Perth. ICIS is a division of Reed Business Information, part of Reed Elsevier Plc.

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